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ANNUAL COMPLIANCE REVIEW, 2013	Docket No. ACR2013

NOTICE OF THE UNITED STATES POSTAL SERVICE OF REVISIONS TO THE FY2013 ANNUAL COMPLIANCE REPORT -- ERRATA
(February 6, 2014)

The United States Postal Service hereby provides notice of revisions to the FY2013 Annual Compliance Report, originally filed on December 27, 2013. The changes are only material for a few small categories of mail and services, but cause non-material changes in the data relating to many other categories as well. In other words, the breadth of these changes far exceeds their depth. The primary impetus for these changes are the updates in the FY2013 RPW extract file materials provided in USPS-FY13-NP31 on January 21, 2014 in response to Question 11 of Chairman's Information Request No. 1. An independent source of other minor changes is a correction regarding FY2013 NSA reporting.

On page 48 of the ACR as filed on December 27 2013, the Postal Service noted that it was continuing to investigate a potential understatement of the revenue for the non-NSA portion of Parcel Select. That investigation led to the need to update the RPW Extract File materials, although, as listed in the Postal Service's response to Question 11 of ChIR No. 1 (January 21, 2014), several other matters were addressed in the extract file update as well. With regard to the non-NSA portion of Parcel Select, the problem seems to have been possibly related to changes in procedures that allowed Parcel Select to be purchased using PC Postage beginning January 27, 2013. The extract file updates caused material changes in the relationship between revenues and costs for the products most directly affected, but also caused extremely minor ripple effects in many other categories because of procedures such as application of the book revenue adjustment factors and the methods by which cost distribution factors are calculated.

The flow of changes relating to this Notice can be described as follows. The updated data in the RPW Extract Files (filed on January 21 as USPS-FY13-NP31) require corresponding changes in some billing determinants (USPS-FY13-NP1) and in the CRA and CRA-related folders (USPS-FY13-1, 2, 31, 32, USPS-FY13-NP11, NP12, NP13, and NP14). The ICRA folders (USPS-FY13-NP2, NP3, and NP4) and incremental cost folder (USPS-FY13-NP10) change as well. Certain folders with a more specific focus (USPS-FY13-28 and USPS-FY13-NP26 regarding Special Services, USPS-FY13-NP27 regarding Domestic Competitive NSAs, and USPS-FY13-NP15 and NP16 regarding parcel cost models) also require revision. As a matter entirely separate from the RPW extract file update, errors were also discovered in the Standard Mail volumes reported in conjunction with the Discover NSA in USPS-FY13-30, and that folder is revised as well (with corresponding revisions made in the CRA folders). A separate Notice is being filed today with respect to the revised public and non-public folders.

The changes in the updated folders create the need to revise the text of the ACR itself. Those revisions are described below. The vast majority of the changes are simply substituting (mostly in tables and a few places in text) a new number for an old number, with very little difference between the two numbers. In the attached revised pages, all numbers that have changed are highlighted in gray. Similarly, in places in which one or two words change (as a result of a change in numbers in a corresponding table), those word changes are also highlighted in gray. As noted below, however, in a few places, entire portions of text were replaced, and those are described but not highlighted.

Page 10	Minor changes in the First-Class Mail table
Page 11	Minor change regarding First-Class Mail Parcels
Page 17	Minor changes in Standard Mail table
Page 18	Minor change regarding Standard Mail Parcels
Page 34	Minor changes in Package Services table
Page 35	Minor change regarding Package Services overall
Page 37	Mostly minor changes in Special Services table, but somewhat larger changes in Other Ancillary Services and Stamped Envelopes
Page 38	Minor change regarding Stamp Fulfillment Services
Page 38-39	Material changes in Discover NSA figures
Page 47	Minor changes in Incremental Cost table and text
Page 48	The revised CRA no longer shows the revenue of the non-NSA portion of Parcel Select below cost, so that product is removed from the list of shortfall products in the first paragraph, and the discussion of that product in the second paragraph is rewritten accordingly. These changes are not highlighted.

Page 50-51   Minor changes in Institutional Cost target discussion figures

Attached to this Notice are copies of the revised pages of the FY2013 Annual Compliance Report.

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Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

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A. First-Class Mail

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for First-Class Mail products appear below.

Table 1: First-Class Mail Volume, Revenue, and Cost by Product

	Volume (million)	Revenue ($million)	Attributable Costs	Contribution	Revenue/ Piece	Cost/Piece	Unit Contribution	Cost Coverage
Single-Piece Letter/Cards	22,498	$10,477	$6,197	$4,280	$0.466	$0.275	$0.190	169.07%
Presorted Letter/Cards	41,144	$14,904	$4,800	$10,104	$0.362	$0.117	$0.246	310.51%
Flats	1,894	$2,513	$1,686	$827	$1.327	$0.890	$0.437	149.10%
Parcels	247	$579	$584	-$5	$2.341	$2.361	-$0.019	99.18%
Domestic NSA First-Class Mail	214	$78	$23	$55	$0.363	$0.107	$0.256	339.30%
First-Class Mail Fees		$136						
Total First-Class Domestic Mail (incl. Fees)	65,997	$28,687	$13,290	$15,397	$0.435	$0.201	$0.233	215.85%
Outbound Single-Piece First-Class Mail Int'l	231	$458	$322	$136	$1.977	$1.389	$0.588	142.33%
Single-Piece First-Class Mail Int;l	226	$150	$228	-$79	$0.662	$1.010	-$0.348	65.58%
Total First-Class Mail	66,454	$29,294	$13,838	$15,484	$0.441	$0.208	$0.233	211.69%

As shown above, with the exception of First-Class Mail Parcels and Inbound Single-Piece First-Class Mail International, all First-Class Mail products covered their attributable costs in FY 2013, with most of them contributing significantly to institutional costs. This comports with the historical role of First-Class Mail as providing the highest contribution to institutional costs of all mail classes. The decline in First-Class Mail volume continues, but at a slowing rate: 6.6 percent in FY2010, 6.4 percent in FY2011, 5.6 percent in FY2012, and 4.3 percent (or 3.0 billion pieces) in FY2013.

The cost coverage of First-Class Mail Parcels fell from 110.0 percent in FY 2011 to 98.4 percent in FY 2012. This likely stemmed from the transfer of commercial First-Class Mail Parcels to the competitive product list; only the retail portion of the product remains on the market dominant product list. In FY2013 there has been a small increase in this cost coverage to 99.2 percent. Based on the recently approved price increases to be implemented on January 26, 2014, the cost coverage for First-Class Mail Parcels will be well over 100 percent.

The failure of Inbound Single-Piece First-Class Mail International to cover its attributable costs stems from the product's unique pricing regime. The Postal Service does not independently determine the prices for delivering foreign origin mail. Rather, these prices are set according to a Universal Postal Union (UPU) terminal dues formula established in the Universal Postal Convention; for the majority of the mail, the formula is based on a percentage of the one-ounce retail Single-Piece First-Class Mail price, while the remainder is priced based on a set rate per kilo, instead of on actual costs. New terminal dues rates effective January 1, 2014 are expected to have a positive effect on revenue and cost coverage for both target and transition countries in FY14.

2. Workshare Discounts and Passthroughs

i. Single-Piece Letters and Cards

The First-Class Mail Single-Piece Letters/Postcards product has one worksharing discount, which is applicable to both Qualified Business Reply Mail (QBRM) Letters and QBRM Cards. The passthrough for both QBRM Letters and Cards is 113.3 percent. A brief history of this particular passthrough shows that the calculated passthrough for this

5. Earned Value Promotion

The Earned Value Promotion (April 1 – June 30, 2013) offered participating mailers the opportunity to earn rebate credits of 2 cents per scanned Courtesy Reply Mail (CRM) or Business Reply Mail (BRM) letter or postcard. Mailers could use the credit toward future mailings of First-Class Mail letters and flats. Over the course of the program period, the Postal Service issued $10.7 million credits, of which $3.5 million were used for First-Class Mail letters and flats in FY2013.

B. Standard Mail

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Standard Mail products appear below.

Table 2: Standard Mail Volume, Revenue, and Cost by Product

Product	Volume (million)	Revenue ($million)	Attribu-table Costs	Contri-bution	Revenue/ Piece	Cost/ Piece	Unit Contri-bution	Cost Cover-age
HD/Sat Letters	5,712	$805	$341	$464	$0.141	$0.060	$0.081	235.8%
HD/Sat Flats & Parcels	11,338	$1,930	$843	$1,087	$0.170	$0.074	$0.096	229.0%
Carrier Route	9,508	$2,373	$1,779	$594	$0.250	$0.187	$0.062	133.4%
Letters	46,754	$9,261	$4,903	$4,358	$0.198	$0.105	$0.093	188.9%
Flats	5,568	$2,134	$2,514	($380)	$0.383	$0.452	($0.068)	84.9%
Parcels	72	$70	$110	($40)	$0.977	$1.524	($0.547)	64.1%
Every Door Direct Mail Retail	975	$138	$38	$100	$0.142	$0.039	$0.103	359.9%
Standard Mail NSAs	1,036	$217	$93	$124	$0.168	$0.071	$0.116	233.0%
Standard Mail Fees		$56						
Total Standard Mail (incl. fees)	80,963	$16,985	$10,621	$6,364	$0.215	$0.135	$0.081	159.9%

As shown above, all Standard Mail products other than Standard Mail Parcels and Standard Mail Flats covered their attributable costs in FY 2013. As a class, Standard Mail covered its attributable costs and contributed significantly to institutional costs.

Under section 3626(a)(6), when the Postal Service adjusts Standard Mail prices, the estimated average revenue per piece for Standard Mail sent by nonprofit mailers must equal, as nearly as practicable, 60 percent of the estimated average revenue per piece for Standard Mail sent by commercial customers. For FY 2013, the ratio was 59.7 percent.

Standard Mail Parcels' cost coverage declined from 85.5 percent in FY2012 to 64.1 percent in FY 2013. This decline comes on the heels of repeated above average price increases – i.e. 2.864 percent in January 2012 (vs 2.041 percent class average); 3.081 percent in January 2013 (vs 2.569 percent class average); and 1.820 percent (based on Docket No. R2013-10) in January 2014 (vs 1.642 percent class average). Despite these aggressive pricing efforts, however, several issues have caused this product's cost coverage to decline. First, on January 22, 2012, a large portion of the Parcels product – specifically, commercial Standard Mail machinable and irregular parcels generally used for fulfillment purposes – transferred to the competitive product list. At the same time, a portion of the Parcels product (formerly titled Non Flat-Machinables) became Marketing Parcels, with different mailing standards. These changes have left the remaining Standard Mail Parcels product with a significantly higher proportion of nonprofit mailpieces, driving down cost coverage. In addition, unit costs for this product increased significantly in FY2013. Consequently, the Standard Mail Parcels product is likely to continue to have a cost coverage below attributable costs in FY 2014. Nevertheless, the Postal Service is committed to improving this product's cost coverage by proposing above average price increases in future price adjustments.

D. Package Services

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Package Services products appear below.

Table 6: Package Services Volume, Revenue and Cost by Product

Product	Volume (Million)	Revenue ($Million)	Attributable Costs ($Million)	Contribution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contribution ($)	Cost Coverage (%)
Parcel Post	29	318	331	(13)	11.077	11.531	(0.453)	96.1
Bound Printed Matter Flats	230	185	130	55	0.805	0.568	0.237	141.7
Bound Printed Matter Parcels	216	275	263	12	1.269	1.216	0.053	104.4
Media Mail/Library Mail	95	316	372	(56)	3.348	3.940	(0.592)	85.0
Alaska Bypass	1	21	10	11	24.437	11.721	12.716	208.5
Fees		3						
Inbound Surface Parcel Post	1	17	11	6	19.930	12.976	6.954	153.6
Total Package Services Mail (incl. fees)[17]	571	1,134	1,118	16	1.987	1.958	0.029	101.5

Two Package Services products failed to cover their attributable costs. Parcel Post had a cost coverage of 96.1 percent, and Media Mail / Library Mail had a cost coverage of 85.0 percent. The January 27, 2013 move of Parcel Post from market dominant to competitive combined with the stand-alone contribution of Alaska Bypass allowed the Package Services mail class to cover attributable costs for the first time since FY2008. Overall, the class had a cost coverage just over attributable costs, at

[17] Totals are calculated from unrounded numbers and then rounded. This is why the rounded totals do not always equal the sum of the rounded subtotals in Table 5.

101.5 percent. The Postal Service intends to attempt to improve the cost coverage of Media Mail / Library Mail over time through price increases.[18]

2. Workshare Discounts and Passthroughs

i. Media Mail / Library Mail

Two passthroughs associated with Media Mail / Library Mail exceeded 100 percent in FY 2013: the Media Mail Basic presort passthrough and the Library Mail Basic presort passthrough. The former is 156.1 percent, and the latter is 141.9 percent, compared to 133.3 percent and 126.7 percent, respectively, in FY 2012. The Postal Service justifies these passthroughs pursuant to section 3622(e)(2)(C), as Media Mail and Library Mail transport matter of educational, cultural, scientific, and informational value. The Postal Service moreover notes that the Commission recently found that these discounts (at higher passthroughs of 156.7 percent and 150.0 percent respectively) are justified pursuant to 39 U.S.C. § 3622(e)(2)(C). Order No. 1890 at 96-97. Nonetheless, the Postal Service plans to move the discounts toward the new cost avoidances over time, while avoiding any drastic changes that could cause rate shock.

ii. BPM Flats and BPM Parcels

Two passthroughs for BPM Flats and BPM Parcels exceed 100 percent. The passthroughs for the BPM Flats and BPM Parcels DNDC dropship discounts are both 121.4 percent. On January 26, 2014, the discounts will be reduced from 17.0 cents to 14.1 cents, in line with the FY 2012 cost avoidance of 14.1 cents but still slightly above the newly calculated FY 2013 cost avoidance of 14.0 cents. When these prices become

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[18] Media/Library Mail cost coverage is expected to improve from the 84.2 percent reported in the FY2013 CRA to 94.3 percent after the exigent prices go into effect. See Steve Nickerson Statement in R2013-11 at Attachment 25.

E. Special Services

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Special Services appear below.

Table 7: Special Services Volume, Revenue and Cost by Service/Product								
Service/Product	Volume (Million)	Revenue ($Million)	Attributable Costs ($Million)	Contribution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contribution ($)	Cost Coverage
Certified Mail	233.9	715.0	535.2	179.8	3.06	2.29	0.77	133.59%
COD	0.5	4.4	3.7	0.7	9.11	7.61	1.50	119.74%
Insurance	28.1	108.4	75.8	32.7	3.86	2.70	1.16	143.09%
Registered Mail	2.2	35.5	28.0	7.5	15.84	12.50	3.34	126.74%
Stamped Envelopes	N/A	10.9	6.5	4.4	N/A	N/A	N/A	168.46%
Stamped Cards	34.8	1.4	0.5	0.9	0.04	0.01	0.03	306.99%
Other Ancillary Services	N/A	514.8	242.6	272.2	N/A	N/A	N/A	212.17%
Total Ancillary Services	N/A	1390.4	892.2	498.2	N/A	N/A	N/A	155.84%
Int'l Ancillary Services	23.9	36.1	18.4	17.7	1.51	0.77	0.74	196.37%
Caller Service	N/A	93.6	22.8	70.8	N/A	N/A	N/A	411.30%
Address Management Services	N/A	15.3	8.4	6.9	N/A	N/A	N/A	182.04%
Credit Card Authentication*	14.7	14.7	1.9	12.8	1.00	0.13	0.87	786.68%
Customized Postage	0.0	0.3	0.1	0.2	315,000	66,126	248,874	476.36%
Int'l Reply Coupon Service	N/A	0.2	N/A	N/A	N/A	N/A	N/A	N/A
Int'l Business Reply Mail Service	0.2	0.2	N/A	N/A	1.45	N/A	N/A	N/A
Money Orders	102.5	156.1	103.3	52.9	1.52	1.01	0.52	151.19%
Post Office Box Service	N/A	358.5	293.9	64.6	N/A	N/A	N/A	121.97%
Stamp Fulfillment Services	2.7	4.2	5.1	(0.9)	1.55	1.87	(0.32)	82.99%
Total Special Services Mail	N/A	2,069.2	1,346.0	723.3	N/A	N/A	N/A	153.74%

*See USPS-FY12-NP26 for cost after revenue-sharing with third-party partners.

One Special Services product failed to cover its attributable costs in FY 2013: Stamp Fulfillment Services. The product had attributable costs of $5.1 million in FY 2013, but listed revenues of only $4.2 million, resulting in a cost coverage of 83.0 percent. The SFS price increases of 25 to 75 percent in January 2012, have significantly improved the cost coverage. Despite this improvement, the Postal Service agrees with the Commission's comments in the 2012 ACD, at 142:

> The costs and revenues associated with the SFS product do not entirely capture the value that the Services Center adds to the Postal Service, and to other Postal Service products. Although SFS does not cover its attributable costs, by providing a mechanism for the centralized ordering of stamps, it reduces the costs associated with the retail purchases of stamps. Thus, it promotes the objectives of reducing costs and increasing efficiency. See 39 U.S.C. 3622(b)(1) and (c)(12).

F. Negotiated Service Agreements

There were two market dominant Negotiated Service Agreements (NSAs) in effect in FY 2013: Discover Financial Services and Valassis. Full information regarding the Discover Financial Services NSA appears in USPS-FY13-30. The Valassis NSA was approved by the Commission on August 23, 2012, in Order No. 1448. Valassis did not send enough NSA-eligible volume to qualify for volume discounts, and paid published rates during FY 2013. Therefore, there are no further data to report.

From a fiscal year perspective, the Discover Financial Services NSA had a volume of 1.250 billion pieces, revenue of $294.5 million, and attributable costs of $115.9 million, resulting in an attributable cost coverage of 254 percent. The Commission reviews NSAs from a contract year perspective, and focuses on the net benefit of an NSA to the Postal Service. As shown in USPS-FY13-30, the net benefit of the Discover Financial Services NSA for the contract year of April 2012 to March 2013 is estimated to be between $26.5 million and $31.9 million.

It is clear, then, that the NSA improved the net financial position of the Postal Service. Furthermore, the Postal Service has no reason to believe that the NSA caused unreasonable harm in the marketplace. The scale of the agreement was sufficiently small to make market effects unlikely, and similar functionally-equivalent NSAs could have been made available to similarly-situated mailers. The Discover Financial Services NSA therefore satisfies section 3622(c)(10)(A) and the Commission's rules.

FY13 INCREMENTAL COST CALCULATION FOR TOTAL COMPETITIVE PRODUCTS[1]

	Attributable Cost	Group Specific	Incremental	Hybrid Incremental
Domestic Competitive Mail	$ 8,610,025	$ 25,681	$ 8,791,025	$ 8,791,025
International Competitive	$ 1,271,028	$ -	na	$ 1,271,028
Total Competitive	$ 9,881,053	$ 25,681	na	$ 10,062,053

[1] Costs are in ($000).

The total competitive hybrid incremental cost is $10,062,053 thousand, which is the sum of the hybrid incremental costs for domestic competitive mail and the hybrid incremental costs for international competitive. In the past, the Commission used attributable cost plus group specific cost for the cross-subsidy test. That proxy would provide a cost floor of $9,906,734 thousand ($9,881,053 + $25,681). The hybrid provides a preferred cost floor because it includes at least some properly calculated incremental costs, and is a better approximation of the true incremental costs required for the test.[24]

The hybrid incremental costs of $10.062 billion are well below total competitive products revenue of $13.741 billion (shown on page 3 of USPS-FY13-1). Therefore, based on these estimates, it is clear that competitive products in FY 2013 were not cross-subsidized by market dominant products, and thus were in compliance with subsection 3633(a)(1).

[24] As demonstrated in Proposal 22, the resulting hybrid will be greater than the group's overall attributable cost (while not overstating the incremental costs for competitive products). This means that the hybrid is a preferred cost floor for performing a cross subsidy test.

ii. Subsection 3633(a)(2)

Subsection 3633(a)(2) requires that each competitive product cover its attributable costs. As shown in the Nonpublic CRA (USPS-FY13-NP11) and the ICRA (USPS-FY13-NP2), after revisions of February 6, 2014, every competitive product covered its attributable costs, with the exception of International Priority Airmail (IPA), International Return Receipt, International Money Transfer Service – Outbound, and Inbound Air Parcel Post (at non-UPU rates).

In addition to those products, the cost coverage for the non-NSA portion of Parcel Select originally appeared to be under 100 percent as well. But the investigation into the possible revenue understatement mentioned in the original ACR revealed that, as shown in the revised Nonpublic CRA, the corrected cost coverage is over 100 percent. Moreover, the Parcel Select product received a 9.2 average price increase in January 2014.

International Priority Airmail (IPA) and International Return Receipt, both relatively small products, provided negative contribution in FY13. The Postal Service continues to consider possible causes for the declines in cost coverage from those recognized in FY12, but it notes that identifying specific causes with small revenue-reporting products is often difficult on a year-to-year basis. Moreover, the subset of IPA under consideration here includes only the non-NSA component, which accounted for 2.3 percent of the volume and 1.1 of the weight of IPA generally, according to the RPW extract report.

changed since the implementation of the PAEA rate review structure and were reported with the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators grouping. This past year, the Postal Service also classified Air Parcels pieces originating in Germany under a new bilateral agreement which was included in the Competitive Multi-Service Agreements with Foreign Postal Operators grouping;[29] however, the Air Parcel volume from Germany was not transferred until the fourth quarter of FY2013 since the new bilateral became effective on July 1, 2013.

iii. Subsection 3633(a)(3)

Subsection 3633(a)(3) states that competitive products must collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs. In its regulations, the Commission has determined that an appropriate minimum share is 5.5 percent of total institutional costs.[30] Page 3 of USPS-FY13-1 shows total institutional costs of $33.149 billion.[31] Applying the 5.5 percent to that figure yields a target contribution of $1.823 billion. Page 3 of USPS-FY13-1 shows total competitive attributable costs of $9.881 billion and total competitive product revenue of $13.741 billion. Subtracting the former from the latter results in total

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[29] Docket No. CP2013-65 (see http://www.prc.gov/Docs/87/87240/Order%201761.pdf).

[30] *See* 39 C.F.R. § 3015.7(c). The Commission In 2012 affirmed 5.5 percent as an appropriate minimum share of total institutional costs to be borne by competitive products. Order No. 1449, Docket No. RM2012-3 (Aug. 23, 2012).

[31] Institutional costs were significantly higher in FY 2012 compared to FY 2011 because the $5.5 billion Retiree Health Benefits Fund prefunding payment due in FY 2011 was deferred to FY 2012, and an additional $5.6 billion Retiree Health Benefits Fund Prefunding payment was already due in FY 2012, resulting in a total $11.1 billion of additional Retiree costs in FY 2012 compared to FY 2011. For FY 2013, the effect was the opposite. Comparing FY 2013 with FY 2012, since only one year of prefunding payment was expensed in FY 2013, the institutional costs for FY 2013 were significantly lower than for FY 2012 (which included expenses for two years of prefunding).

competitive contribution of $3.860 billion, greater than the $1.823 billion target. Thus, the subsection 3633(a)(3) requirement was met in FY 2013.